1. a. While it is true that managers have a fiduciary duty to shareholders, it is human nature for managers to put their own interests ahead of those of the stockholders when there is a conflict in objectives. It is impossible for stockholders to monitor the actions of all managers at all times, so agency problems are inevitable.

b. The types of mechanisms used to keep agency problems under control generally involve monitoring of management, contracts that relate management compensation to firm performance, and market mechanisms such as takeover threats and competition in the market for managerial employees.

2. Other financial intermediaries include insurance companies, mutual funds and pension funds. In Japan, banks provide relatively more financing than do other financial intermediaries, while in the U.K., other financial intermediaries provide substantially more financing. In the U.S., banks are less important sources of financing compared to financial intermediaries, and in Europe, financing provided by banks and financing provided by other financial intermediaries are approximately equal.

3. Transparency is essential in a market-based system, but is not necessarily a requirement for a bank-based system. In a bank-based system, banks have long-standing working relationships with the companies seeking financing, and banks have on-going access to information about the firm. In a market-based system, creditors and equity-holders require that financial information about companies seeking financing be available, sufficiently detailed and accurate if they are to participate in the market. This information, including audited financial statements, allows participants in the market to make judgments about a firm’s profitability and prospects for the future. Without this information, investors are not willing to participate in the financial markets.

4. A company with dual-class equity has two classes of common stock with different voting rights. One of the best known examples of a company with dual-class equity is Ford Motor Company; the Ford family owns a class of common stock with extra voting rights, which allows the family to control the company.
5. Becht identifies ‘ownership dispersion’ both as a pre-requisite for stock market liquidity and as a hindrance in terms of corporate control. An ideal governance system should concentrate control without destroying liquidity. In addition, Becht states that the ideal governance system must assure that “those who command the voting power must have the right incentives.” (“European Corporate Governance,” p.1072)

ING’s corporate governance system completely separates ownership of the company from voting power. Voting power is held entirely by the trust office, which is effectively self-perpetuating. A trust agreement defines the fiduciary duties of the trust office. Cash flow rights are held entirely by owners of the nonvoting depository receipts; Becht suggests that cash flow rights define ownership. Thus, ownership dispersion is accomplished without forfeiting corporate control. The remaining issue is whether ING’s system provides the ‘right incentives’ for the trust office. In general, one might expect that concentrated control could result in ineffective protection for minority owners. Becht observes that, in fact, this has not been the case: “There have been no indications of minority abuse at ING. The company is well managed and investors … do not appear to be deterred by the ING control structure.” (“European Corporate Governance,” p.1076)

6. Variation in the level of criminal activity from one country to another depends on a complex interaction of economic, sociological, political, legal and cultural factors. The combination of factors that results in low levels of criminal activity is also likely to reduce the level of corporate agency problems; agency problems often rise to the level of criminal activity as indicated, for example, by the indictment and prosecution of Tyco CEO Dennis Kozlowski, and other corporate executives in the U.S., in the first few years of this century. In both the U.S. and the U.K., corporate managers are legally obligated to act in shareholders’ best interests. It seems likely that the same combination of factors that reduces criminal activity in general is likely to reduce corporate agency problems as well.

7. New industries seem to develop in market-based financial systems such as the U.S., while bank-based systems, such as Japan and Germany, seem to be successful in sustaining established industries. The automobile industry, for example, grew and developed in the U.S., but Japan and Germany have sustained a competitive advantage in recent decades. As new industries or products develop, there often appear to be several potential avenues for development, each requiring significant amounts of financing before the eventual industry leaders emerge. A bank-based system is not likely to provide this early-stage financing because of the uncertainty involved, but a market-based system provides financing from numerous investors with different views regarding prospects for development. Market-based systems also seem to be more effective in eliminating declining firms and industries.
8. Pyramids allow a wealthy family, for example, to control a group of companies with a relatively small investment. This allows the family to diversify their holdings while maintaining control of the group. In the U.S., investors can diversify their holdings in the financial markets, so a pyramid or a conglomerate is not necessarily a desirable alternative. In developing countries, however, the substandard financial markets do not provide a desirable mechanism for diversification and expansion.

9. A Japanese keiretsu is a network of companies with cross-holdings and numerous interrelationships. These include long-standing relationships among the companies in the keiretsu, and between the companies and the bank that is often associated with the keiretsu. The advantages of this form of organization include the ability to obtain debt financing from the keiretsu’s bank or from other affiliated financial institutions. Financing can also be obtained from other companies in the keiretsu, avoiding the need for external financing. Keiretsus tend to have relatively stable cash flows and are often able to resolve issues related to the financial distress of a company in the keiretsu. A disadvantage of this form of organization is the fact that outside shareholders have little, if any, influence on the companies in the keiretsu. As a result, dividends are relatively low and takeovers are extremely rare.